

NONRESIDENT ALIEN

POLICY AND PROCEDURE MANUAL

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Payee Identification Numbers

Any recipient whose income is effectively connected with an U.S. trade or business must obtain and furnish you with an U.S. taxpayer identification number (TIN). If the nonresident alien does not have a TIN he must apply for one. The payee's TIN may be any of the following.

- Social Security Number (SSN) - use Form SS-5 to apply for a SSN. The Social Security Administration will tell the individual if he or she is eligible to get a SSN.
- Individual taxpayer identification number (ITIN) - use Form W-7. If you are an individual and are not eligible for a SSN you must get a ITIN.
- Employers identification number (EIN) - use Form SS-4. Any person other than an individual who is an employer or sole proprietor must apply for an EIN.

No payments may be issued until the TIN has been obtained.

The agency will be responsible for entering the payee ID, name and address information into the STARS vendor file. Use **Vendor Type '9'** for all nonresident aliens. This vendor type is exempt from the 1099 process. Since we will be issuing form 1042-S to the payees based on data obtained from our database files, we do not want them to be issued a 1099 out of STARS.

The address to set up in the vendor file should be the address where the warrant is to be mailed. The address for mailing of the annual 1042-S form will be contained in the A&R database customer file.

If a foreign payee is being reimbursed for travel expenses only and his payment is neither taxable nor reportable, then a **dummy ID number** may be set up in STARS using the F number series. Example F12345678. This series is only to be used where you are reasonably certain that this payee will not be getting any taxable or reportable payments.

Make sure to notify Accounts and Reports of any address changes. Our database is not tied to STARS and therefore must be updated manually.

IRS Form W-8

Per IRS publication 515, form W-8 is to be used for all Non Resident Alien payments and should be obtained for all NRA payments, not just the one's claiming a withholding exemption. The form W-8 should not be submitted to the IRS, instead it should be kept on file in your agency. There are four different W-8 forms that can be used depending on the circumstances. Below are summary's of the four different W-8 forms. For more information see attachment #9.

Form **W-8BEN** : Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding.

Use form W-8BEN if the payee is the beneficial owner of the income, whether or not it is claiming a reduced rate of, or exemption from, withholding.

Form **W-8ECI** : Certificate of Foreign Person's Claim for Exemption From Withholding on income Effectively Connected With the Conduct of a Trade of Business in the United States.

Use form W-8ECI if the payee is the beneficial owner on the income and it claims that the income is effectively connected with the conduct of a trade of business within the United States.

Form **W-8EXP** : Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding.

Request form W-8EXP from any foreign government, international organization, foreign central bank of issue, foreign tax-exempt organization, or foreign private foundation to which you are making a payment.

Form **W-8IMY** : Certificate of Foreign Intermediary, Foreign Partnership, or Certain U.S. Branches for United States Tax Withholding.

Use form W-8IMY if the payee is an intermediary acting as custodian, broker, nominee, trustee or executor, or other type of agent for another person.

Acceptance Agent Agreements

Introduction

Per the terms of an Acceptance Agreement, the Internal Revenue Service (IRS) may recognize an organization as an Acceptance Agent of the IRS in order to facilitate and expedite the application process leading to the issuance of Individual Taxpayer Identification Numbers (ITIN's). An Acceptance Agent may accumulate, certify, and forward necessary Passport and Visa information to the appropriate IRS processing office for assignment of an ITIN. A "Certified" Acceptance Agent is additionally authorized to submit Form W-7 (Application for IRS Individual Taxpayer Identification Number) to the IRS on behalf of applicants without having to furnish certified copies of Passport and Visa documents to the IRS. (Refer to Exhibit 1 for an example of Form W-7 and related instructions.) The instructions provided on the following pages were written under the assumption that the organization has agreed to act as a Certifying Acceptance Agent as opposed to a standard Acceptance Agent.

If Form W-7 is not processed through a Certified Acceptance Agent, the applicant is otherwise required to attach certified copies of his/her Passport or two forms of ID to Form W-7. Certified copies of the Passport can only be obtained from IRS or U.S. consulate offices, which often places a burden on applicants.

Obtaining an Acceptance Agent Agreement

An organization interested in becoming an authorized Certifying Acceptance Agent (pursuant to section 301.6109-1(d)(3)(iv) of the Income Tax Regulations and Revenue Procedure 96-52) must provide certain assurances to the IRS through the form of a standard agreement document provided by the IRS. If your organization is interested in obtaining a Certifying Acceptance Agreement, contact the IRS at (202) 874-1467 or at the following address:

Department of the Treasury
Internal Revenue Service
950 L'enfant Plaza South, S.W.
Washington, D.C. 20024

Processing ITIN Applications

The Certifying Acceptance Agent must perform the following procedures when processing Form W-7:

- A. Require that the applicant be physically present when the applicant provides the original Passport and Visa documents to an individual designated in the IRS agreement as a Certifying Acceptance Agent.
- B. Make copies of the original Passport, Visa and any other relevant documents provided by the applicant. Note 'Original Document Copied' on document copies and sign and date the copies.
- C. Complete the Nonresident Alien ITIN Application Checklist (Exhibit 2). Do not process Form W-7, if the applicant is eligible for a Social Security Number or if the applicant is not associated with the Acceptance Agent's organization. All items on the checklist must be satisfied before processing Form W-7. Any special circumstances must be documented in writing.
- D. Assist the applicant in completing Form W-7. Several items to note when completing form W-7 are detailed below:
 - The Permanent Residence Address (Line 2) should be the applicant's foreign address, not his/her local address
 - The Mailing Address (Line 3) should be the Acceptance Agent's business office.
- E. Verify that Form W-7 information is consistent with supporting documents and that the applicant's signature is attached.
- F. Write the code number associated with the type of document (such as Passport) provided by the applicant, in Form W-7's 'For IRS USE ONLY' block. (Refer to Exhibit 4, for the 'Listing of codes to Insert on Form W-7'.)
- G. Sign and date Form W-7, in the 'Acceptance Agent's Use Only' block.
- H. Complete and sign the Acceptance Agent Certification Statement (Exhibit 3) and attach the Certification Statement to Form W-7.
- I. Submit the completed Form W-7 and related Acceptance Agent Certification Statement to the IRS, at the following address:

Internal Revenue Service
11601 Roosevelt Boulevard, D.P. 426
Philadelphia, PA 19255

The IRS processes Form W-7, assigns an ITIN number, prepares the applicant's ITIN Card (Exhibit 5) and mails the ITIN Card to the Acceptance Agent at the mailing address noted under D above. The Certified Acceptance Agent forwards the original ITIN Card to the applicant and retains a copy. The IRS takes approximately two months to assign an ITIN number, so advance planning is required for timely payment to the applicant.

A Certifying Acceptance Agent must retain copies of relevant documents and related interview notes/checklists for a period of three calendar years following the year in which

Form W-7 is mailed to the IRS. Relevant documents are all the documents and records related to the assistance furnished to the applicant on an ITIN including copies of Form W-7 submitted to the IRS on behalf of the applicant, copies of documentary evidence attached to Form W-7, copies of ITIN cards issued by the IRS, and documentary evidence upon which the Certifying Acceptance Agent has relied to certify the applicant's alien status and identity to the IRS.

Direct Payments to Nonresident Aliens

Certain payments made to or on behalf of a nonresident alien must be reported to the Internal Revenue Service. In addition, all reportable payments are subject to federal and state income tax withholding unless they are specifically exempted by the U.S. tax law, or by an income tax treaty. Payments requiring tax withholding are taxed at 19% (14% federal, 5% state) for scholarships/fellowships and 35% (30% federal, 5% state) (or graduated withholding rates depending on the type of payment or tax treaty provisions) for all other payments.

Before you can determine how to tax a particular payment to a nonresident alien, you must first determine the nature of the payment (wages, independent contractor payment, scholarship/fellowship, etc.)

A. Compensation v. Scholarship/Fellowship Grant

Whether a payment made to a nonresident alien to study or conduct research should be treated as compensation for services rendered or as a scholarship/fellowship grant is of critical significance. If the payment is treated as compensation paid to a nonresident alien employee, tax must be withheld at the standard graduated rates applicable to U.S. citizen employees¹ with certain restrictions. If the payment is compensation paid to an independent contractor (for example, a visiting lecturer), tax must be withheld at a 35% rate.² If the payment is treated as a scholarship/fellowship grant, some or all of the grant payment may be excludable under section 117 and the taxable portion may be subject to tax withholding at a reduced rate of 19%. If the payment represents any other type of payment (e.g., royalty, dividend, interest, etc.) withholding will be required at the standard nonresident alien tax rate of 35%. ³ All of these conclusions, of course, are subject to any exclusion allowed under the Internal Revenue Service Code and/or exemptions or modifications allowed by income tax treaties.

B. Gift v. Scholarship/Fellowship Grant or Compensation

It is quite difficult to successfully treat a payment to a nonresident alien individual for education or training as a “gift” instead of as a scholarship/fellowship grant. Also, if the recipient is an employee, the payment cannot qualify as a gift under section 102, although it could be exempt as a de minimis fringe benefit⁴ or as a qualified employee achievement award.⁵ If a payment is treated as a gift, however, the withholding agent does not have to withhold any tax because under section 102 the entire gift is excludable from the recipient’s income.⁶

C. Loan v. Scholarship/Fellowship Grant or Compensation

Under general principles of U.S. tax law, the receipt of loan proceeds does not result in taxable income. Therefore, if a scholarship/fellowship payment made to a foreign individual can be characterized as a scholarship “loan,” the total amount of the loan is tax free to the recipient, not just the “qualified scholarship” amount that might be excludable under section 117.

Whether a payment should be treated as a scholarship/fellowship grant or a nontaxable loan is a question of fact that depends on the circumstances of each case. Generally speaking, the IRS will conclude that a “true” loan exists where the recipient (“borrower”) has a legally binding obligation to repay the amount. The same “bona fide obligation to repay” principles apply if the individual to whom the loan is made is an employee. If treated as a loan, no withholding is required because the loan is not treated as taxable income to the recipient.⁷ If, however, the loan is “forgiven,” the amount is considered to be income to the individual at the time it is forgiven, and taxable at the standard nonresident alien tax rate of 35 percent.

D. Prize or Award v. Scholarship/Fellowship Grant

Whether an amount is considered a “prize or award” or a “scholarship or fellowship” is dependent upon the nature of payment. If the payment is based on a past accomplishment or activity, it will generally be considered a prize or award. However if the payment is for a future or continuing educational activity that does not require the performance of a service, it will generally be considered a scholarship or fellowship.

If the payment is considered to be a prize or award, a 35 percent rate of withholding will apply. Also, there are currently no income tax treaties that allow a tax exemption for prizes or awards.

¹ Section 1441(c)(4); Treas. Reg. 1.1441-4(b)(1)(I).

² Section 1441(a).

³ Section 1441(b).

⁴ Section 132(a)(4) and (e).

⁵ Section 274(j).

⁶ Section 1441(b).

⁷ Section 1441(b).

This information was obtained from Donna E. Kepley’s book titled, *Nonresident Alien Tax Compliance: A Guide for Institutions Making Payments to Foreign Students, Scholars, Employees, and Other International Visitors*.

Indirect Payments to Nonresident Aliens

Per IRS Publication 515 , withholding is required at the time you make a payment of an amount subject to withholding. **A payment is made to a person if that person realizes income whether or not there is an actual transfer of cash or other property. A payment is considered made to a person if it is paid for that person's benefit.**

Travel Exemption

The Offices of Internal Revenue Service (IRS) Associate Chief Counsel (EB/EO) and Associate Chief Counsel (International) in Washington, D.C., in mutual consultation have informally agreed that the so called “accountable plan rules” and the working condition fringe benefit rules allowed by sections 62, 132, 162, 274 of the Internal Revenue Code are applicable to nonresident alien individuals as well as to U.S. citizens and resident aliens. This means that payments made to, or on behalf of, nonresident alien individuals for the purpose of defraying or reimbursing the travel and lodging expenses of such nonresident alien individuals are excludible from the gross income of such nonresident alien individuals and are not reportable to the IRS by the payors of such payments, on the condition that the requirements of the accountable plan rules are met.

The requirements of the accountable plan rules require that the payee must (1) establish the business purpose and connection of the expenses; (2) substantiate the expenses claimed to the payor within a reasonable period of time; and (3) return any amounts to the payor which are over and above the substantiated business expenses within a reasonable period of time. Amounts which are over and above the substantiated business expenses, or which are not accounted for within a reasonable period of time, are reportable to the IRS on form W-2 and are subject to withholding of employment taxes (or are reportable on form 1042-S and are subject to section 1441 withholding, as the case may require).

Travel and lodging reimbursements may also fall under the definition of employee working condition fringe benefits as defined by section 132 of the Internal Revenue Code. Revenue Procedure 97-59 explains the application of these rules in more detail. In addition, Revenue Ruling 63-77 states allowances or reimbursements made to individuals by a prospective employer for expenses incurred in connection with interviews for possible employment, which are conducted at the invitation of the prospective employer, are not “wages” subject to Federal employment taxes and the withholding of income tax.

To the extent reimbursements do not exceed the expenses incurred, they are, under the circumstances, not includible in the gross income of such individuals for Federal income tax purposes.

Nonresident Alien Taxation of Scholarships:

The first step is to determine if the individual is a nonresident alien for tax purposes. There are two tests that are used to determine whether a non-U.S. citizen should be treated as an U.S. resident for tax purposes: the “green card” test and the “substantial presence” test. If the non-U.S. citizen satisfies neither test, he is taxed as a **nonresident alien**. The “green card” and “substantial presence” tests are defined in the following section.

All amounts paid to nonresident aliens in the form of scholarships, fellowships, grants, and financial aid must be reported to the IRS on forms 1042, annual summary, (Exhibit 6) and 1042-S, individual statement, (Exhibit 7), regardless of the amount paid, and regardless of whether the amounts are taxable. This does not include scholarships nonresident alien students receive from sources outside the university. The issuing agency is responsible for the reporting and withholding on the awards they grant to nonresident alien students.

All amounts paid to nonresident aliens in the form of scholarships, fellowships, grants and financial aid are subject to federal income tax withholding at the rate of 35% (30% Federal Withholding and 5% State Withholding) unless the payments are exempt from tax under the Internal Revenue Code or a tax treaty. However, payees who are temporarily present in the U.S. holding F-1, J-1, M-1 or Q-1 visas (see Exhibit 8 for different visa types) are subject to withholding at only 19% (14% Federal Withholding and 5% State Withholding) of the taxable portion of the award.

If the individual is a candidate for a degree at the university, the portions of a scholarship, fellowship, or grant that are used to pay tuition, fees, books, supplies, or equipment required for enrollment are considered qualified educational expenses and are not taxable under section 117 of the Internal Revenue Code. Any portion of the scholarship, fellowship, or grant over and above qualified educational expenses is taxable.

Any nonresident alien student who claims that part or all of his scholarship or fellowship is exempt from taxation because of a tax treaty must have Form W-8 on file. Ownership, Exemption, or Reduced Rate Certificate, (Exhibit 9) with the central accounting office. If the tax treaty benefit expires before three years, the student should notify the central accounting office by letter that his treaty benefit has expired. The university should keep all Forms W-8 on file for inspection by the IRS in case of examination. The university is responsible for monitoring tax treaty benefit eligibility period for each student who has filed a Form W-8, and is responsible for withholding income tax at 19% or 35% on the taxable portion of the scholarship or fellowship after the tax treaty benefit eligibility period has expired.

Determining residency for tax purposes:

A. Green Card Test

Does the individual have a Green Card?

- Aliens who have a Green Card are Resident Aliens for tax purposes.

B. Substantial Presence Test

The individual must pass both the 31-day and 183-day tests to be considered a resident alien for tax purposes.

- 31-day test:
 - Was the individual present in the U.S. 31 days during current year?
- 183-day test
 - Current year days in U.S. $\times 1 =$ days
 - First preceding year days in U.S. $\times 1/3 =$ days
 - Second preceding year days in U.S. $\times 1/6 =$ days
 - Total days in U.S. = days

If “Total days in the U.S.” equals or exceeds 183 days, the individual has passed the 183-day test.

D. Exception to 183 day test:

- DO NOT count days in which the individual was an “exempt individual”
 - Definition of Exempt Individual:
 1. Teacher, trainee, researcher on J or Q visa is an exempt individual for the first two calendar years in the U.S.
 2. Student with F, J, M, or Q visa is an exempt individual for the first five calendar years in the U.S.

NOTE: The term “exempt individual” simply means the individual will be exempt from counting days toward the calculation of substantial presence test. The term does not mean the individual is exempt from having federal or FICA tax withheld.

If the individual answers “yes” to the Green Card test or exceeds 183 days in the Substantial Presence test, he is considered a resident alien for tax purposes.

Tuition Waivers/Reductions

Tuition waivers, fellowships, scholarships, or grants paid to or on behalf of nonresident aliens which **require that the recipient perform services** in exchange for the reduction or aid (such as graduate assistantships) are taxable as wages, are reportable to the IRS, and are subject to withholding rules.

However, some exceptions to this general rule are applicable under certain facts and circumstances.

Staff rates afforded to institutional personnel are not waivers of fees, and are considered to be pricing adjustments of the State. Kansas Statutes, Administrative Regulations and Board of Regents Policy grant staff tuition rates at resident rates to employees working at least 40% time. This authority includes student salaried employees as well.

Kansas Administrative Regulations 88-3-9, which is included in Appendix D of the Kansas Board of Regents Manual, defines the employee authorized staff rate as the resident rate. The Board of Regents authority for setting staff rates is in Kansas Statutes Annotated 76-729. See Exhibit 10 for these two references.

The staff rate assessment is considered to be a tuition pricing policy because the staff rate is a privilege accorded to only salaried employees with at least 40% appointments. This pricing policy does not confer resident status. Instead, the individual's status as an employee authorizes assessment at a given rate regardless of their residency and any other assessment is incorrect according to established state policy.

Waiver of hourly tuition for graduate teaching assistants (GTA) is considered a qualified scholarship but not a payment. GTAs are employed by institutions and paid through the payroll process. Generally, the GTA wage falls within a range that reflects the market rate for the services provided. Additionally, GTAs are granted a waiver of tuition but because they are otherwise adequately compensated for their services, this reduction in fees is considered a qualified scholarship. As a qualified scholarship used for tuition, the amount would be exempt from withholding. See Exhibit 11 for reference on qualified scholarships.

Tuition waivers or reductions would not be considered payments because they do not meet the definition of a periodic payment per code section 1441 and code section 6041. IRS regulation Sec 1.6041-1 addresses the requirements for return information for payments aggregating to \$600 or more. Although that section does not specifically address tuition waivers, it does define when a payment is deemed to be made per the following statement. "For purposes of a return of information, an amount is deemed to have been paid when it is credited or set apart to a person without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and is made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition." A tuition waiver that is a qualified scholarship would not meet this standard and therefore would not be reportable. Exhibit 12 references pertinent parts of code sections 1441 and 6041.

Miscellaneous tuition waivers granted to any nonresident aliens will have to be reviewed to determine if the same standards, as discussed above, could be applied to them. Each waiver will need to have the related facts and circumstances evaluated to determine whether any reporting or withholding would be required. Each institution will have responsibility for evaluating their own waiver policies.

Tax Treaties

The United States has income tax treaties with a number of foreign countries. Under these treaties, residents of foreign countries are taxed at a reduced rate or are exempt from U.S. income taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income. Exhibit 13 provides a summary of U.S. tax treaty provisions with individual countries.

In order to claim tax treaty benefits a resident of a foreign country must prepare one of the following forms:

- A. Form 8233, Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual. (Refer to Exhibit 14 for a copy of Form 8233 and related instructions.) This form is required to claim an exemption from withholding, if the individual is performing personal services.

The resident of a foreign country is required to include a taxpayer identification number on Form 8233. If the person has a SSN, the SSN must be used as the taxpayer identification number. If the person does not have a SSN and is not eligible to receive a SSN, he/she must apply to the IRS for an ITIN. Refer to the Acceptance Agent Agreements section of this document, for additional information on how to apply for an ITIN.

In order to claim an exemption from withholding, Form 8233 must be filed with the IRS through the entity paying the nonresidents prior to payment at the following address:

Office of the Assistant Commissioner (International)
Director, Office of International District Operations
Attn: CP:IN:D:C:SS
950 L'Enfant Plaza South, S.W.
Washington, D.C. 20024

- B. Form W-8, and its sub forms, W-8BEN, W-8ECI, W-8EXP and W-8IMY, must be obtained from all non-resident aliens requesting payment. This form replaces Form 1001 which was only filed when payee was claiming exemption from withholding. See Attachment 8 for more information on the various W-8 forms and their uses.

Personal Exemption Calculations

To reduce the income tax withheld from taxable scholarships, a nonresident alien is entitled to claim one personal exemption. The exemption amount is the same personal exemption allowed for U.S. residents. When applying the personal exemption to a scholarship, the exemption must be prorated if the student is in the U.S. for less than a full calendar year. In situations where a nonresident alien student has compensation from employment and a scholarship, the personal exemption can be claimed only in connection with one source of income.

See IRS Publication 515 for the current year exemption amount and the current year daily prorated rate. The rate for calendar year 2004 is \$3100 and the daily proration rate is \$8.47 per day.

Completion of Internal Revenue Service (IRS) Forms

A. Form W-7, Application for IRS Individual Taxpayer Identification Number

Any individual who is not eligible to obtain a social security number (SSN), and whose taxpayer identification number is required to be furnished to the IRS, must apply for an individual taxpayer identification number (ITIN) on Form W-7. An ITIN is a nine-digit number issued by the IRS to individuals who are required to have an U.S. taxpayer identification number but who do not have, and are not eligible to obtain, a SSN. ITINs are intended for tax use only. The numbers create no inference regarding the immigration status of a foreign person or the right of that person to be legally employed in the United States. The person that needs an ITIN can apply at most IRS offices or through an acceptance agent. Refer to the Acceptance Agent section of this procedure, for more information regarding acceptance agents.

B. Form 8233, Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual

In general, income tax withholding at 35% (30% federal, 5% state) is required on payments to nonresident aliens for independent personal services (self-employment). Withholding is also required (sometimes at 35% and sometimes at graduated rates) on compensation for dependent personal services paid to nonresident alien students, professors/teachers, and researchers. However, some payments may be exempt from withholding because of a tax treaty or the personal exemption amount. A nonresident alien should complete and file Form 8233 with the withholding agent (university) to claim these exemptions from withholding.

For independent personal services (self-employment), Form 8233 is used to claim a tax treaty exemption and/or the personal exemption amount. For dependent personal employment, Form 8233 is used only to claim a tax treaty exemption for any part of the compensation that is exempt from withholding; Form W-4, Employee's Withholding Allowance Certificate, is used to claim the personal exemption amount.

When the nonresident alien individual submits Form 8233, review it to verify that exemption from withholding is warranted. If exemption is warranted (based on the facts presented), complete and sign the certification in Part II of the form. Four copies of the completed Form 8233 will be needed. The instructions for Form 8233 outline distribution of the copies. One copy must be submitted to the IRS within five days of acceptance.

C. Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding

Form 1042-S is prepared by the State (A&R) and is used to report income paid to nonresident aliens except for dependent personal services income that is required to be reported on Form W-2. A separate Form 1042-S is required for each recipient of income to whom payments are made. A separate Form 1042-S may be used for each type of income that is paid to the same recipient; or more than one specific type of income may be reported on the same Form 1042-S for the same recipient.

A&R will file Form 1042-S with the IRS by March 15. The recipient of the income should also receive Form 1042-S by March 15. Consult the instructions for Form 1042-S for magnetic media/electronic reporting instructions.

D. Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons

Form 1042 is prepared by the State (A&R) and is used to report tax withheld on certain income of nonresident aliens and to transmit paper Forms 1042-S, Foreign Person's U.S. Source Income Subject to Withholding. Form 1042 is required when Form(s) 1042-S are filed (whether or not any tax was withheld or was required to be withheld).

A&R will file Form 1042 with any paper Forms 1042-S and other required forms and attachments with the Internal Revenue Service Center, Philadelphia, PA 19255, by March 15.

E. Form W-8BEN, W-8EXP, W-8ECI and W-8IMY. One of these forms must be filed by all non-resident aliens requesting payment. See attachment 8 for the actual forms and instructions.

F. IRS forms and instructions can be obtained at the following WEB site:

<http://www.irs.ustreas.gov/prod/cover.html>

Select "Forms and Publications" at the bottom of the page.

Nonresident Alien – Centralized Reporting

All reportable payments to nonresident aliens must be processed through the Department of Administration, Division of Accounts & Reports, who will act as a central reporting agent for all nonresident alien transactions statewide. Remittance of federal and state tax withholding amounts, filing of annual returns and issuance of annual 1042-S forms will be handled by A&R and submitted under one federal identification number which is 48-1124839. Procedures for submitting information to A&R for processing are detailed below.

Dates for Reporting Information to A&R

- A. **Payments or waivers where withholding is due:** Payment information and withholding should be submitted to A&R when payment is requested. Withholding on waivers should be submitted to A&R at the point the waiver benefits the recipient.
- B. **Information submitted for reporting purposes only (exempt from withholding):** Information may be accumulated by the agency and submitted periodically to A&R. Information must be submitted at least once per year. Information for the current calendar year must be submitted to A&R by January 15th, of the following year.
(Example: A&R must have calendar year 2004 info by January 15, 2005).

Withholding Rates

- A. Federal – 30%, or 14%(income code 15) on certain scholarship payments, or other based on tax treaty.
- B. State – 5% on all payments that are subject to any federal tax.

Agency Payment Preparation

Voucher – Except for the items noted below, the agency should prepare the payment voucher in the normal manner. **NRA payments should be batched separately and the batch marked ‘NRA Payment’.**

If there is no withholding:

- A. The voucher amount will be for the total amount to be paid.
- B. All payments that are exempt from withholding under exemption code ‘4’, should have a form 8233 attached or it should be indicated on the voucher that a form W-8 is on hand at the agency. Payments exempt under exemption code ‘2’ do not require forms 8233.

- C. Attach form DA-35NRA and complete the bottom portion only.
- D. A&R will review & approve the voucher, enter data in database and process the voucher through STARS by releasing the batch or whatever is necessary.

If there is withholding:

- A. The voucher amount will be the gross payment less both federal and state withholding. (example – If gross payment = \$500.00, federal withholding = \$150.00, state withholding = \$25.00, then the voucher amount is \$325.00). The voucher description should include the gross award, federal withholding, state withholding and net voucher amount.
- B. Attach form DA-35NRA and complete both the top and bottom portions. An example of form DA-35NA is included in Exhibit 16.
- C. A & R will review and approve the voucher, enter reporting information included on form DA-35NRA in the database, and process the voucher and DA-35NRA journal voucher information in STARS.

DA-35NRA form – All payments submitted should have a DA-35NRA form attached (Exhibit 16).

All payments should have a journal voucher number assigned on the DA-35NRA form whether or not withholding is required. The journal voucher number will be the reference number assigned to all payments filed with A&R. All journal voucher numbers should begin with J3____. The next 3 digits will be your agency number, example for KU would be J3682____. The last three digits will be the next sequence number assigned by your agency starting with 001, 002, 003, etc. . . . example – KU's first three payments submitted would be J3682001, J3682002 and J3682003. If all available numbers are used in any one calendar year (if you have more than 999 payments) contact A&R to be assigned an additional series of numbers.

Include information in the top portion of the JV form to transfer the withholding amounts from the agency account to the A&R clearing funds.

Include detail information in the bottom portion of the JV form to update the A&R reporting database. A&R will use this database to report payment information to the IRS and the Kansas Department of Revenue.

Complete the 1042-S mailing address block, may be different than the address on the payment voucher. This address will be where the 1042-S form is mailed.

The instructions listed below clarify information to include in specific blocks of the DA-35NRA form. Instructions for completing specific information blocks are cross-referenced to the form included in Exhibit 16.

A. STARS transaction entry section (Top Section)

1. Current Doc. No. – Will be completed by agency using numbers in a block assigned by Accounts and Reports. Example: J3***xxx, *** = agency number, xxx = next available document number.
2. Document Date – Date prepared.
3. Effective Date – Date to be processed by A&R (may be left blank).
4. SFX – (suffix) – line number – begin with 01 and increment by 01 for each new line.
5. T/C – Transaction Code – use 783.
6. Agy – Agency number – 3 digit agency number.
7. Fund – Fund number – 4 digit fund number.
8. BFY – Budget Fiscal year – 2 digit fiscal year identifier.
9. Index – Index Code – 4 digit index code.
10. PCA – Program Cost Account – 5 digit PCA number.
11. Exp. Obj. – Expenditure Subobject Code – Appropriate 4 digit expenditure classification.
12. Amount – Dollar amount associated with this transaction line.
13. Suffix numbers for A & R funding lines.
14. BFY – Budget Fiscal Year.
15. Amount – Total of Federal withholding to be transferred to the A&R clearing fund.
16. Amount – Total of State withholding to be transferred to the A&R clearing fund.
17. Journal Voucher Total.

B. Information required to complete form 1042-S (Bottom Section)

- A. Voucher number – Voucher number of the corresponding payment voucher, if applicable.
2. Recipient's Taxpayer ID number – SSN or ITIN.

3. Recipient Code – 2 digit payee type identifier - from table in IRS Form 1042-S Instructions for Form 1042-S.
4. Recipient's Country of Residence for tax purposes – from table in IRS Form 1042-S Instructions for Form 1042-S.
5. Country Code – from table in IRS Form 1042-S Instructions for Form 1042-S. Make sure to verify correct code.
6. Income Code – identifies type of payment – from table in IRS Form 1042-S Instructions for Form 1042-S.
7. Tax Rate – 30%, 14%, or '0' if payment is exempt from withholding.
8. Exemption Code – 2 digit code identifying source of exemption from withholding – from table in IRS Form 1042-S Instructions for Form 1042-S, page 5, under 'Authority for Exemption'. This block should contain a '00' if the payment is subject to withholding, do not leave it blank. Usually '02' or '04' exemption codes used.
9. Gross Income – Contract amount prior to any adjustments
10. Withholding Allowance – may be calculated for taxable payments – see instructions in IRS publication 519. (Income codes 15 & 16 only).
11. Net Income (Taxable) – Block 9 minus block 10. (Income codes 15 & 16 only).
12. Federal Income Tax Withheld – Block 11 multiplied by block 7.
13. State Income Tax Withheld – Block 11 multiplied by applicable state rate (currently 5%).
14. Voucher Amount – Block 9 minus blocks 12 & 13.

The completed form should be signed and dated by an authorized agency official and should accompany the corresponding payment voucher and the copy of form 8233 (if applicable), when sent to A&R for processing.

Payment Submission

- A. Payments should be submitted to A&R to the attention of the Appropriations Team.
- B. Payment should include batch sheet, journal voucher, payment voucher, payment supporting documentation. Agency should retain any required exemption documentation on file.

- C. A&R will audit, approve, enter the payment into our database, process the attached JV, if withholding is required, and process the voucher for payment.
- D. Payments that involve withholding must be entered into the database the same day the warrant is issued in STARS. This is because the Federal deposit requirements are based on the total withholding to be remitted at certain times of the month. The date is automatically posted in the database so we need to make sure it coincides with the date STARS shows for the other half of the payment as closely as possible.

Electronic submission of payments

Agencies may submit their payment information to A&R via electronic submission. Data must be sent in an ASCII text file layout that matches our ACCESS database. **See Exhibits 17 & 18 for the customer and payment file layouts.**

When data is submitted electronically, agencies must also submit a hard copy summary for A&R's files. The hard copy summary should include a cover form DA-35NRA for filing reference purposes. Agencies can include as many transactions as they desire in the electronic file and send only one hard copy DA-35NRA form to cover the entire file submitted. Electronic files must be submitted as two separate files (a customer file and a payment file).

Customer file – Contains the payee's mailing address. Customer file information must always be entered into the database prior to entering payment file information into the database. The customer file should contain the address where the form 1042-S is to be mailed after the end of the tax year.

Payment file – Contains actual payment data. Payment file information is used in processing withholding deposits to the IRS and the State Department of Revenue. Information in the payment file is combined with customer file information for the issuance of annual 1042-S forms.

Withholding Deposit Requirements

If at the end of any month the total amount of undeposited taxes is less than \$200, the state is not required to make a federal deposit that monthly period. The balance is carried forward to the next period. If the total undeposited taxes is between \$200 and \$2,000 the state must deposit the taxes within 15 days after the end of the month. If the total of undeposited taxes is \$2,000 or more on the 7th, 15th, 22nd, or end of the month the state must deposit the taxes within 3 banking days.

On each payment cutoff date, Accounts and Reports will review the balances in the clearing funds for Federal & State withholding and remit withholding to the IRS and State Department of Revenue as necessary.

Annual returns must be filed for both federal and state withholding, summarizing all deposits made for that calendar year. These returns will be filed by A&R. Form 1042 is the Federal return and form KW-3 is the State return.

The annual 1042-S Forms are printed and mailed by Accounts and Reports. We will send a copy to the IRS via electronic filing. The electronic filing instructions are maintained in Accounts and Reports

Transaction Correction Procedures

The following are the instructions to follow if an error is discovered after a nonresident alien transaction has already been submitted to Accounts and Reports. For a copy of the correction form, see exhibit 19.

A. New Warrant Issued For Same Amount

- Agency – Cancel original warrant. After warrant has been canceled, submit a corrected voucher and a completed NRA-Database/Payment Correction form. A JV form should be submitted with the voucher for filing reference purposes only. (A JV entry is not required since withholding amounts were previously deposited.)
- A&R – Federal and State Deposits. No additional action required since correct amount was deposited.
- A&R – NRA Database – Update database to add new voucher number and make any other necessary corrections, based on reason for cancellation (amounts will never change).
- A&R – NRA Files – Write the cancellation date and replacement voucher number on the file copy of the original voucher. Attach the replacement voucher in front of the original canceled voucher.

B. New Warrant Issued For Larger Amount Than Original

- Agency – Cancel original warrant. After warrant has been canceled, submit a completed NRA-Database/Payment form with the corrected voucher. A journal voucher, for the amount of **additional** required withholding, should be attached to the correction form.
- A&R – Federal and State Deposits – Deposit additional required withholding amounts when the next deposit is made.
- A&R – NRA Database – Change the canceled payment's gross income, net income and taxes withheld to \$0.00. Enter the replacement voucher in the Database in the normal manner and enter the total required withholding amount, not just the increased amount. (This is necessary because the original payment and withholding amounts were changed to zero).
- A&R - Balancing – After the deposit is made the total of year-to-date deposits made should equal taxes remitted per the database.

- A&R – NRA Files – Mark on the file copy of the canceled payment “Canceled (date)” and cross reference to the replacement voucher and journal voucher submitted with the replacement voucher.

C. New Warrant issued For Smaller Amount Than Original

- Agency – Cancel original warrant. After warrant has been canceled, submit a completed NRA-Database/Payment correction form with the corrected voucher. A JV form should be submitted with the voucher as usual for filing reference purposes. (A JV entry is not required since the withholding has already been deposited.)
- A&R – Federal and State Deposits – No additional deposit required. A&R will manually track the difference between the amounts originally deposited and the adjusted withholding amounts per the corrected voucher. Amounts over deposited will be adjusted in the next deposit period involving payments from the affected agency.
- A&R – NRA Database – Original payment amounts are adjusted to 0, and adjusted payment amounts are entered into the database. A&R will manually track amounts over deposited, so these amounts can be deducted from the next federal and state deposits.
- A&R - Balancing – After the next federal and state deposits are made, amounts previously over deposited are netted out. Amounts deposited should equal deposit amounts in the payment file
- A&R – NRA Files – Write “canceled (date)” and a cross reference to the replacement voucher on the file copy of the cancelled payment.

D. No New Warrant Issued

- Agency – Send NRA-Database/Payment correction form indicating payment was canceled.
- A&R - Deposit – The amounts withheld will be manually subtracted from the amounts of the next deposits.
- A&R – NRA Database – Change gross income, net income and taxes withheld, for cancelled payment, to \$0.00.
- A&R - Balancing – After the next federal and state deposits are made, total year-to-date deposits should equal taxes remitted per the database.
- A&R – NRA Files – Mark on the file copy of the canceled payment “canceled (date)”.

- A&R - Only Payment to Payee During Year – If this is the only payment made to this payee, the payee's records must be deleted from the NRA database to ensure that the payee does not receive a form 1042-S.

E. Other Corrections

If a correction that won't affect the warrant needs to be made to the NRA database, prepare a NRA-Database/Payment correction form and send the form to A&R. A&R will update the database file and attach the correction form to the DA-35NRA referenced.

Foreign Source Income

A. U.S. Source Income – General Income

The rules used to determine the threshold question of whether an individual should be treated as a “U.S. resident” or a “nonresident alien” for tax purposes are complex. Many differences exist between how the U.S. taxes these two categories of foreign visitors. Perhaps the most important difference is that U.S. resident aliens, like U.S. citizens and permanent resident aliens, are taxed on their worldwide income while nonresident aliens are taxed only on income they receive from U.S. sources (typically referred to as “U.S. source income”). The distinction between “U.S. source” or “Foreign source” income is extremely important to institutions making payments to foreign nationals because very different rules apply depending on how the payment is classified.

U.S. tax law classifies all types of income (interest, dividends, rent, compensation for services, etc.) as either “U.S. source” or “foreign source,” and different “sourcing” rules apply to each income category.⁸ For example, the source of dividend income is based on the nationality of the payor corporation, and rental income is sourced in the country in which the rental property is located.⁹ Thus, dividends received by a nonresident alien from a foreign corporation and rental income received with respect to property located outside the U.S. are classified as “foreign source” income. If income received by a nonresident alien is classified as “foreign source,” it will not be subject to U.S. tax.¹⁰ If however, an amount received by a nonresident alien is treated as “U.S. source,” the income is potentially subject to U.S. tax. It is only potentially subject to tax because of an exclusion contained in either the Internal Revenue Code or an income tax treaty. (**NOTE:** A resident alien is subject to tax on his worldwide income; a nonresident alien is subject to tax only on his income from U.S. sources.)

B. How to Source Compensation Paid to Employees and Independent Contractors

If a nonresident alien receives income from the performance of personal services, either as an employee or an independent contractor, the sourcing rule is quite simple – the income is sourced to the country where the services were performed.¹¹ If compensation income is earned with respect to services performed both within and without the U.S., the income is generally prorated between U.S. and foreign source on “time spent” basis.¹² In determining the source of any compensation income, the residence or nationality of the payor of the compensation is irrelevant, as is the place and time of payment and the currency in which the payment is made.

There is, however, a limited exception to the “location of the performance of the services” sourcing rule. This exception provides that even though the services are

performed in the U.S., the income received by the nonresident alien will not be treated as U.S. source income if:

- The nonresident alien was not present in the U.S. for more than 90 days; and
- The income does not exceed \$3,000; and
- The services are performed for (I) a nonresident alien, foreign partnership or foreign corporation not engaged in a U.S. trade or business, (II) the foreign office of a U.S. citizen, partnership, or corporation, or (III) the U.S. government.¹³

C. How to Source Scholarship and Fellowship Grants

Before 1989, the IRS had followed a “location of the educational activity” test.¹⁴ This test was similar to the compensation sourcing rule in that a scholarship/fellowship grant was sourced to the country where the student or fellow performed the educational activities for which the scholarship or fellowship was granted. Under this sourcing rule, it did not seem particularly fair that a student from Germany who received a grant from BMW Foundation, situated in Germany, to study in the U.S. should be required to pay tax on the money from the German BMW Foundation simply because he chose to study in the U.S. In theory, under this income sourcing rule, the population of foreign students who chose to study in the U.S. would ultimately decline based on the unfair application of the tax law.

In 1989, however, the IRS issued Revenue Ruling 89-67,¹⁵ which set forth a new “residence of the payor” test. The IRS described the reason for changing the sourcing rule as follows:

It is more appropriate to source [scholarship/fellowship] payments at the residence of the payor, where the principal economic nexus with the payment exists, than at the place where the study and research... activities are performed, where the economic nexus is less significant.¹⁶

Under this “residence of the payor” test, if an individual studies or performs noncompensatory research in the U.S., but receives a grant from a non-U.S. person or entity, the payments will be “foreign source” income and not subject to U.S. tax. Conversely, if the student receives the award from an U.S. person or entity, the payment is treated as “U.S. source” income, regardless of where the educational activities take place.

Revenue Ruling 89-67 points out that, in determining the “residence of the payor,” the sourcing conclusion is not affected if payments are made by an “intermediary agency” acting on behalf of the payor. **Example:** The government of France funds scholarships for French students to study in the U.S. and contracts with the U.S. organization to administer these grants. What is the source of these

funds? The payments will be treated as “foreign source” because the “true” payor is a foreign entity, with the U.S. organization acting simply as an agent.

It is significant to note, however, that the intermediary entity will be disregarded **only if** there is, as stated in Revenue Ruling 89-67, a “genuine agency relationship” between it and the payor of the scholarship or fellowship. Although the existence (or nonexistence) of such a relationship is usually clear, difficult factual situations can arise. Finally, it is important to note that under Revenue Ruling 89-67 scholarship/fellowship payments made by an “international organization” are treated as foreign source income. The term “international organization” is defined as an organization designated as such under the International Organizations Immunities Act and includes the World Bank, the United Nations, and others.¹⁷

D. Grants that are Both U.S. and Foreign Source

If a grant required study or research both within and outside the U.S., the source of the payments will be the same because, in either event, the residence of the payor is the same. In addition, if a grant is funded jointly by an U.S. source income, the portion attributable to the U.S. entity would be U.S. source income, while the portion attributable to the foreign entity would be foreign source.

E. Combination Sourcing Rule

In late 1995, the IRS issued final regulations under section 861 that retain the basic “residence of the payor” sourcing rule, but carve out an exception for scholarship/fellowship payments made by a U.S. payor to a nonresident alien studying outside the U.S. The regulations provide that these payments will be treated as “foreign source” income, and therefore not subject to U.S. withholding tax. The regulations also provide that the sourcing rule does not apply to scholarships/fellowships awarded in connection with the performance of service. In addition, the regulations extend the “location of the payor” sourcing rule to prizes and awards issued to nonresident aliens. Finally, because the regulations were in proposed form for several years and many withholding agents used the proposed regulations as if in final form, the regulations provide that the provisions described above will be applied retroactively to years after 1986.

⁸ Sections 861-863

⁹ Treas.. Reg 1.861-3 (dividends); Treas.. Reg 1.861-5

¹⁰ Section 872 (computation of gross income for nonresident alien individuals); and Sections 881 and 882 (computation of gross income for foreign corporations).

¹¹ Section 861(a)(3)

¹² Treas.. Reg. 1.861-4(b)

¹³ Section 861(a)(3)(A)-(C).

¹⁴ Rev. Rul. 66-292, 1966-2 C.B. 280.

¹⁵ 1989-1 C.B. 233.

¹⁶ 1989-1 C.B. at 234.

¹⁷ Section 7701(a)(18).

This information was obtained from Donna E. Kepley's book titled, *Nonresident Alien Tax Compliance: A Guide for Institutions Making Payments to Foreign Students, Scholars, Employees, and Other International Visitors*.

U.S. Income Sourcing Rule

	Location of Payor	Location of Activity	
		U.S.	Outside U.S.
Compensation (Dependent or Independent Services)	U.S	U.S. Source Income	Foreign Source Income
	Outside U.S.	U.S. Source Income	Foreign Source Income
Scholarship/Fellow- ship (Non-Service)	U.S.	U.S. Source Income	Foreign Source Income
	Outside U.S.	Foreign Source Income	Foreign Source Income

Reporting Activity of Affiliated Organizations

A. Scholarships

A scholarship paid directly by a foundation (or endowment association) to a nonresident alien should be reported to the Internal Revenue Service (IRS) by the foundation on Form 1042-S, unless arrangements have been made to report the scholarship as a university scholarship.

A scholarship held by a foundation, but paid to a nonresident alien through the university, should be viewed as a university scholarship and reported to the IRS on form 1042-S through the state via a DA-35NRA Form.

A scholarship paid to a nonresident alien by a separately incorporated athletic corporation shall be reported to the IRS by the corporation on Form 1042-S.

B. Other Payments

All other payments to nonresident aliens shall be reported to the IRS on Form 1042-S (or Form W2 if for wages) by the affiliated organization that made the payment.

NONRESIDENT TO RESIDENT **STATUS IN SAME YEAR**

If a nonresident alien student becomes a resident during the year, count him/her as a resident for the entire calendar year. Per the IRS, when a person changes from a resident alien to a nonresident alien, the residency takes effect the 1st day of the calendar year they were in this country.

If an individual receives a payment while they are outside of the U.S. and then comes into the U.S., they will be considered a nonresident prior to his entrance in the U.S. and a resident thereafter. In this case he could get a 1042-S and a 1099, both in the same year. Once they become a resident they are subject to Social Security Taxes.

The type of Visa under which the aliens are in the U.S. can have a factor in the above determinations. The cases mentioned above are based on someone in this country under a J1 Visa.